"Magma Fincorp Limited Q3 FY 2017 Results Conference Call"

February 10, 2017

ANALYST: **MR. KAITAV SHAH -SBICAP SECURITIES LIMITED**

MANAGEMENT: **MR. SANJAY CHAMRIA - VICE CHAIRMAN & MANAGING DIRECTOR – MAGMA FINCORP LIMITED**
MR. KAILASH BAHETI – CHIEF FINANCIAL OFFICER – MAGMA FINCORP LIMITED
MR. KAUSHIK BANERJEE, PRESIDENT AND CEO OF ABF BUSINESS– MAGMA FINCORP LIMITED

Moderator: Ladies and gentlemen good day, and welcome to the Magma Fincorp 3Q FY2017 Post Results Conference Call, hosted by SBICAP Securities Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kaitav Shah from SBICAP Securities. Thank you and over to you, sir.

Kaitav Shah: Thank you. On behalf of SBICAP Securities I would like to extend a warm welcome to all the participants on the call, we have the pleasure of hosting the top management of Magma Fincorp represented by Mr. Chamria, Vice Chairman and Managing Director, Mr. Kaushik Banerjee, President and CEO of ABF business and Mr. Kailash Baheti, CFO.

Initially we will have a brief round of remarks from Mr. Chamria and then we can open the floor for Q&A. Over to you sir.

Sanjay Chamria: Thank you Kaitav. Good morning and welcome to the third quarter investor call for Magma. First I would share my views on the economy and demonetization.

The monsoon had generally been good this year and we have rightly expected that the Kharif Crops has been strong, however the demonetization in November the recovery in the rural economy has got delayed, and we feel that it may take about two quarters for the full normalcy to return. We have also gone through some pain due to the impact of demonetization on the rural economy.

I will break the impact on our business in two parts, first the impact on the collections due to the severe cash crunch in the initial days of demonetization especially in rural India and second the impact of the same on our new business.

Our collections were severally impacted in the initial two weeks after the event. Subsequently except for tractors the collections improved for all the other products in December and reached almost normal levels in January. For tractors, the collection efficiency was significantly lower in November and while it improved month-on-month in December and January, we are yet to reach the normal levels.

We know the fact that the new currency started reaching rural India only in December and that too in the third week. Further November, December, our bullet EMI months for tractor loans, because it coincides with the harvesting season. Therefore the inability of tractor customers to pay the installment was entirely situational.

Geographically as well in the state of Haryana, Punjab and Madhya Pradesh where the contribution of tractors is higher than the average; the collections were most impacted in November and December. The collection in these states has also reverted to normal in January.

Our collection efficiency in the third quarter of FY2017 was 90% compared to 97% in Q2 of FY2017 and 92% in Q3 of FY2016. So on a Y-o-Y basis; it is down by 2% whereas on a Q-o-Q basis it is down by 7%. However the improvement in tractor collections, overall collection efficiency improved 97% in January. Therefore we believe that with remonetization of the rural economy farmers, in rural India will be better off in Q4 as they will get realizations from both Kharif and Rabi crops. Hence we do expect a claw back in collections in the tractor portfolio in the fourth quarter.

Overall disbursement in the third quarter declined 5% Y-o-Y and 6% Q-o-Q due to the sharp fall in primary demand across all business segments. The impact of demonetization was more pronounced in mortgage business and to a certain extent in the SME business.

In mortgage, there was a sharp decline in inquires due to uncertainty in real estate prices post demon, we tightened our underwriting as well due to the general uncertainty in the real estate segment and there was a decline in the ticket size. These factors led to a sharp decline of 56% Y-o-Y in the mortgage businesses in the third quarter. We believe this decline is temporary in nature. The push to affordable housing by the government of India coupled with a general drop in the housing prices shall revise the demand in the segment we are catering to sooner than later.

In SME, the decline in general business activity in initial weeks after demon resulted in 9% Y-o-Y decline in disbursal in the third quarter, however disbursal growth in SME business improved into December and reverted to near normal in January. Expansion of the SME to the second and the third tier town from the existing Magma branches, new product launches and the other initiatives will result in the strong growth momentum for SME vertical in the Q4 and in FY2018.

In case of ABF business while the growth was impacted due to the demon, the impact in Q3 has been less severe compared to SME and the mortgage business. Disbursements in the ABF business was up 10% Y-o-Y in Q3 largely due to the strong October which was the best month for FY2017 till date. The month of November and December are traditionally are better than this month but witnessed negative growth. January also has seen a negative growth in ABF disbursals as the primary demand is yet to recover to normal level and I feel that disbursement growth in the Q4 to be muted. On the joining of the new leadership team in ABF in November, we have taken new initiatives to improve field officer's productivity, product specialization, branch categorization, direct business, and derisking of the asset mix. We expect these new initiatives to result in significant improvement in ABF business both in terms of growth and asset quality in FY2018.

Against our expectation of Q-o-Q growth and AUM due to demon, there is as decline of 1% Q-o-Q and 6% Y-o-Y to Rs.17345 Crores. Our strategy to focus on high average products, which is used assets, tractor, SME and the mortgage, will continue. Despite temporary impact on these products due to demon, we believe these products have a strong growth potential and will contribute in improving our overall profitability.

These products now contribute 61% of AUM and we expect them to increase to 70% by end of FY2018.

We believe negative impact of demon on tractor collection is temporary and expected to improve sharply by March. We have already witnessed some improvement in January. We have used RBI dispensation on asset classification for tractor portfolio. Our gross and net NPA in Q3 stood at 9.9% and 7.5% respectively. Increase in the NPA ratios from the last quarter has also been due to a decrease in the loan book. Our coverage ratio has improved by 200 basis points Q-o-Q to 26%. If we had not availed the RBI dispensation for the tractor portfolio our gross NPA would have been higher at 10.5% and PAT would have been lower by 12 Crores.

Resolution of NPA has been a focus area for FY2017. Prior to demon we had largely arrested the net increase in the NPA. We are confident that adoption of branch banking model with special attention to resolve higher-bucket NPAs and implementation of risk management framework shall structurally improve our overall quality of the book in coming quarters.

I would now like to share the key highlights of our performance for third quarter and its impact on our results. Our disbursements in the quarter declined 5% Y-o-Y leading to AUM degrowth of 6% to Rs.17345 Crores. Share of our focus products, which is, used assets, tractor, SME and mortgage increased to 61% on the total loan book. Decline in cost of funds by 10 basis points Y-o-Y and increased contribution of the high margin projects led to the NIM expansion of 18 bps Y-o-Y to 7.4% in the quarter. We expect the NIM for the full year to above 7%. Our Opex ratio increased in the third quarter due to the extra efforts we had put in collection and also due to the lower book; however our efforts to contain cost will continue in coming quarters. Our credit cost at 2.4% is higher than last quarter and corresponding quarter last year largely attributed to increase in the coverage ratio and demon; we expect this ratio to improve in the coming quarters. Decline in PAT by 30% Y-o-Y to Rs.36.5 Crores is largely due to the impact of demon on our cost and higher provisions.

Now Kailash, Kaushik and myself are ready to take any questions that you all may have. Thank you.

Moderator: Sure. Thank you very much. We will now begin the question and answer session. We have the first question from the line of Subhranshu Mishra from Anand Rathi. Please go ahead.

Subhranshu Mishra: I just want to understand there is a note which says that Magma Housing Finance was an unlimited liability company prior to 19th December, any specific reason why it was so Sir.

Kailash Baheti: Subhranshu good morning. This company if you would recollect we have taken over from GE. GE as a part of their global structuring had all the companies in India, which were unlimited liability. So when we have taken over it was an unlimited liability company, subsequently we have been trying to put in our efforts to convert into a normal limited liability company. There was some procedural delay as the government electronic process was not up to the mark but now they have given approval, so it has got converted.

Subhranshu Mishra: And secondly Sir I wanted to understand what your growth targets are going forward in terms of your disbursement and the yields that you get on your CV and SME portfolio sir.

Sanjay Chamria: As we had shared earlier we were expecting the book to start growing from the third quarter of the year, but in the month of October actually we saw a good disbursal growth however after demon November, December and January again have set us back and therefore there is a marginal degrowth. So as I mentioned in the original address that we expect the full impact of demon to go away in about two quarters, because we cater largely to the rural markets and rural markets are the one, which have been significantly impacted by the lack of cash availability. So I think that the Q4 will remain muted and maybe post Q1 and thereafter the growth should begin and our focussed products will remain used assets, tractors, SME and mortgage, and whereas we do not expect our disbursals to grow much in the passenger vehicles, commercial vehicle, and construction equipment. So overall this is what we expect and next year certainly we expect to start growing our loan book because last two years our loan book has marginally degrown.

Subhranshu Mishra: So what would be our loan growth numbers it you have to model that in Sir, for FY2018?

Sanjay Chamria: See we would not like to give any number on this, we would just like to see how the things pan out, but it will not be very a high growth could be in the region of 10%-15%.

Subhranshu Mishra: Okay, sure Sir and what are the yields that you get on your CV and SME portfolio sir.

Sanjay Chamria: On CV we get a yield of about 13.5% to 14% and on SME, we get about 17.5% to 18%.

Subhranshu Mishra: Thank you so much for your time sir. Best of luck.

Moderator: Thank you. We have the next question from the line of Avinash Singh from Jefferies. Please go ahead.

Avinash Singh: Hi Sir, a couple of questions. The first one would be in terms of your disbursement growth, I mean as you said that monsoon was good and festive season, so October and in fact up to first week of November, the growth would have been really good so even if we say that 5% growth in that first half of the quarter then it means implicitly the second half you have a sort of degrown by double digit percentage so where in terms of disburse on the run rate is currently and second question more in terms of your experience on in terms of ground activity in this used vehicle, used CV and used tractor segment because there have been different commentaries coming in terms of the pile of inventory and then increased inventory due to this Bharat Stage BS-IV coming so what are the activity levels on ground in the used CV and used tractor markets. Thank you.

Sanjay Chamria: I am not sure if I have understood your question right, let me still attempt to answer it and maybe you can revert later in case you find it is not fully taken care.

See even in the third quarter, we have had a marginal growth in the vehicle finance business and this was because October was the best month in FY2017, but November and December obviously the growth came down because of the demon impact. The one which got max impacted was the mortgage business where actually the degrowth was quite severe and on an overall basis. Therefore, there was a de-growth. This is my first answer. So far as the used assets and the pile up of inventory is concerned so we find that the demand for the used assets has also gone down post demon, however we expect that to recovery better and faster than the demand for the new vehicles. So as far as the pile up of the inventory is concerned, our experience on the repossession and sell thereof has been normal and we have not seen any extraordinary inventory pile up in the last three months which is November, December, and January.

So, Kaushik would you like to add something from your side on the business outlook on the vehicles and the used vehicle situation.

Kaushik Banerjee: I think you have covered pretty much what was asked in the form of the question and I agree that there will be the movement the economy returns to a predemonetization situation there should be an uptake in terms of traction on the used CV side and in fact with the registration of vehicles, which are older and the registration is older than 2005 be scrapped, there could actually be a larger demand going forward and I see no reason why this segment cannot continue to grow quite robustly within portfolio parameters that we set for ourselves.

Avinash Singh: In terms of your disburse rate, how was January 2016, is it flat or still in the negative territory.

Sanjay Chamria: I would like to share it product wise. SME it is near to normalcy, in mortgage also it has improved but is still lower than pre-demon and in vehicle finance also it is lower than pre-demon and therefore we gave an outlook that Q4 we expected to remain muted.

Avinash Singh: Thank you.

Moderator: Thank you. The next question is from the line of Umang Shah from Emkay Global. Please go ahead.

Umang Shah: I have got two questions one was on the housing finance business, I just wanted to understand as to clearly demonetization would have had its impact but what we have been seeing is that disbursements in the housing finance or the mortgages business have been slowing down for almost three quarters now. So just wanted to understand is there some change in the strategy that we are seeing which is leading to these kinds of numbers.

Sanjay Chamria: Yes you are right Umang in fact right from the beginning of the current fiscal have remodeled our housing business and much before the announcement of various SOPs by the government on the affordable housing segment, we started our journey and I am happy to share with all of you that in the current year which is called nine month ending December 2016 the ticket size in the entire home loan book that we have built is about 13-14 lakhs and in the LAP segment it is about 16 lakhs and the overall housing and LAP book is about 15 lakhs. So therefore we actually lent to more number of customers in the first nine months of this year compared to the first nine months of the last year. However with the ticket size going down, the average disbursals went up. The impact of demonetization further accentuated the situation in the third quarter. So now we are almost stabilizing and we hope that once the housing demand picks up in either the current quarter or maybe the first quarter of the next fiscal that is when we also start growing our housing book, but we have now chosen to operate maximum between 10 lakhs and 25 lakhs and a very small component between 25 and 50 lakhs and we hardly have any new loans which has given beyond 50 lakhs ticket size.

Umang Shah: And this will remain as one of our key focus growth areas.

Sanjay Chamria: Absolutely.

Umang Shah: Sir and my second question was on operating expenses so clearly at sometime in the previous fiscal where we change our strategy in the operating model now it has been almost six quarters where we have seen very good control on Opex. For past six quarters our Opex has been either declining or flat how long do you think you can control Opex line at this level I mean I am sure at some point in time we will start seeing our Opex moving up as well.

Sanjay Chamria: I think the focus on the cost optimization is what I will use the word rather than reduction will continue unabated and I would largely agree with you that we have now reached the targeted levels of absolute amount of Opex that we incur in the company and now the Opex ratio will be a function of growth in the loan book. In fact we did a inter-firm comparisons and while in the third quarter, we are at 3.7% Opex ratio compared to an industry median of 3.3%, but some of the players in the industry have grown at about 16% or 15% whereas we have degrown by 6% so therefore adjusted for the loan book growth our Opex is pretty much in line with the industry leader so I think we have achieved the targeted optimization of the Opex. Now I think all that we have to do is to work on profitable growth of the AUM which is there as Kaushik shared in the ABF and with the various initiatives that we are planning, we propose to start growing the book on good credit quality and in mortgage, also as I shared with you that with the average ticket size being 14-15 lakhs which is a great position to be in and we are already lending more number of contracts than we did same period last year, we are pretty much on course to start growing our housing book. SME book anyway has been growing. In fact in the current year it has already grown at about 10% for the first nine months and we are hoping to grow it much bigger next year.

Umang Shah: That is perfect. Thank you so much and wish you all the best for future quarters.

Moderator: Thank you. We have the next question from the line of Abin Rasheed from IFMR Capital. Please go ahead.

Abin Rasheed: One question is like what is the proportion of the used CV book out of this around some 17,345 Crores of AUM Sir.

Sanjay Chamria: I think we have shared in slide #18 of the investors PPT know, 12% of the overall book is actually the used assets.

Abin Rasheed: And one question is India Ratings is saying FY2018 would not be much good for new vehicles and there is a policy of VVMP also so combining both how do you see the FY2018 for used commercial vehicle Sir.

Sanjay Chamria: Kaushik would you like to take this question.

Kaushik Banerjee: The projection for new commercial vehicles is anyway between 8% to 10% growth, according to the CRM forecast and it is never possible to actually give a projection on used vehicles because it is an existing stock. So it is very difficult to estimate how much of that will come as free from finance and what is the actual stock in the market. So having said that my view is slightly probably different from India Ratings because according to what the finance minister kind of indicated in his budget and I agree there is a difference between an allocation and the actual implementation, he has talked about a 3.89 lakh Crores investment in agri, infrastructure and housing and all of these allocations augur well for the CV industry and if it is with the investment, I agree it augurs well for the tractor industry as well as investments and infrastructure and housing that augurs well for the CV industry. There is a significant possibility of job creations which again increases disposable income which should hopefully drive the consumption side and lead to a potential growth in the last mile transportation vehicle segment as well, so I would rather be optimistic than pessimistic about the opportunities for the CV industry and the tractor industry for FY2018. In fact I was talking to a tractor OEM and he was saying that the FY2017 will close at about 580,000 units for tractors and estimate for FY2018 is about 640,000 tractors for the year, which is a fairly robust growth rate and as I said 8% to 10% for new CVs give or take a couple of a percentage points. So if the plan comes through which has been presented by the finance minister I think there should be and if the monsoons are good there should be adequate traction for all these sectors. Used, very difficult to project, used is up to the company in terms of and how much each company wants to grow the used asset book by.

Abin Rasheed: Thank you Sir. Good luck.

Moderator: Thank you. We have the next question from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Yes. Thank you very much Sir for the opportunity. Sir my first question pertains to your commentary that you mentioned that you expect tractor and other segment to improve sharply by March, so kind of provision that we have provided, do you expect some write-back.

Sanjay Chamria: I mentioned that in case of tractor portfolio we have availed the RBI dispensation and this was on the back of two developments, one is that was the most impacted segment in terms of collections because their installments come entirely on cash and rural India as we all know that cash after remonetization did not reach until third week of December and secondly the problem was also accentuated for the November and December as the bullet EMI months because it coincides with the harvesting season. So we therefore expected that the delayed recovery, the sale of the Kharif crop and as well as the rabbi crop so in the month of January, February and March, we expect a significant claw back in the portfolio quality so far as tractor is concerned and that was the reason why we decided to use the RBI dispensation only for tractor and not for the other asset class and then I shared also that in the month of January we have seen also that the tractor collections have improved sharply but it is still not reach the normal levels so I think it remains to be same but we are hopeful that in the month of February and March we should be able to claw back but if that happens there will not be any write back because we have not created the provision in case of tractor by utilizing the RBI dispensation.

Deepak Poddar: But in other segment, we have created this provision right so…

Sanjay Chamria: That we have created.

Deepak Poddar: So do we expect these things to improve for other segment as well basically, which can actually create some reversal?

Kaushik Banerjee: Of course we would like to see some reversal happening in the Q4 because we have taken extra hit in the third quarter because while tractors were most impacted, the other segments have been impacted though the impact has been lesser so when the recovery happens and the money flows then obviously we expect good recoveries as we mentioned that in the month of January we have reached our overall collection efficiency of 97%, so if that kind of a trend continues in Feb and March and as it is last quarter is always good so we can hope to get some of the provisions back but I think it remains to be seen has to how it will pan out.

Deepak Poddar: So this 97% is a cumulative efficiency that you are talking about.

Sanjay Chamria: It is for the month.

Deepak Poddar: It is for the month of January.

Sanjay Chamria: Yes.

Deepak Poddar: And my second question pertains to demonetization impact in the sense in the past we have been talking about credit cost of 1.25% to 1.5% range and ROA of around 1.5% plus, so is that still intact basically or is there any change to our view.

Sanjay Chamria: So this quarter the ROA, ROE has definitely fallen, the profit is significantly lower, we have to wait and see how it works in the last quarter but we may actually have lower than what we may have presented earlier because of the demonetization impact.

Deepak Poddar: So I was talking about FY2018 basically this was our kind of effort to do for FY2018 that is what we in the past calls we have discussed, so is that what still we are aiming at for FY2018.

Sanjay Chamria: I think yes.

Deepak Poddar: That is it from my side. Thanks.

Kaushik Banerjee: Sanjay to the earlier question on the composition of used assets in the overall book slide #18 on the presentation gives that data as 11.5%.

Sanjay Chamria: Yes that is what I have mentioned also roughly about 12% of the total asset composition is on account of the used assets.

Kaushik Banerjee: So the person who asked that question, it is on slide #18.

Moderator: Thank you. We will move to the next question. The next question is from the line of Adesh Mehta from Ambit Capital. Please go ahead.

Adesh Mehta: Sir we have seen the yields coming down by around 95 bps on a Y-o-Y basis so what could be the driver of this.

Sanjay Chamria: I did not get your question I do not think we have seen a drop in the yield why do you say that.

Adesh Mehta: I take the total income divided by the average on book assets.

Kailash Baheti: Sorry total income divided by average loan book assets so that would be our NIMs has remained same, our IRR has not dropped but if you divide the total income by assets there would always be some interest reversal when the accounts become NPL when there is higher movement in the NPAs and this quarter of course excluding the tractors we have taken the hit for whatever else has moved up and that would have impacted this movement but 19 basis points…

Sanjay Chamria: Mr. Adesh what I see and you can also refer to our investors PPT that for nine months YTD our NIMs have improved by 38 bps from 6.8% to 7.18% and if you compare on a Y-o-Y basis for the quarter it has improved by 18 bps from 7.19% to 7.37% so I do not really understand where you got this number where there is a 90 bps reduction maybe if you have done a calculation on the numbers then you could have a offline conversation with Sanket and Kailash and they would be happy to walk you through but as Kailash mentioned that our gross yields have marginally improved whereas our cost of fund has gone down and the combined impact of these two has been an increase in the spread as well as the NIMs though it could have been sharper but for the higher NPAs that results in the interest reversal and therefore to that extent NIMs would have been negatively impacted but net-net after all of this, there is an improvement in the NIMs.

Adesh Mehta: I will send you my calculation sir and what could be the interest reversals this quarter.

Sanjay Chamria: Well I do not remember it off hand maybe again that is something they will provide you offline.

Adesh Mehta: And another thing Sir for the first time you are seeing that our cost of funds has come down meaningfully below 10% after a long time so what is your outlook on cost of funds going forward.

Kailash Baheti: I think the liquidity in the market is pretty sufficient and one of the positive impacts of the demon has been banks are flushed with money and they have not having enough revenues to lend especially in the corporate side and therefore all the money is finding its way to the retail and we being a retail player and therefore the cost of refinancing has been falling sharply and therefore, I would assume that going into the FY2018 also the interest rate scenario will remain benign and I would expect very strongly the cost of funds to remain below 9% if not go even for to 9.75% maybe for the next year.

Adesh Mehta: Because what we are seeing is that maybe what I can presume is that this decline in cost of funds that has come just from cut in base rates and if you migrate further to bond borrowings that can further lower your cost of funds. So how is the response been in bond markets like have you tried venturing out in that segment and raising capital from there and.

Kailash Baheti: So we continue, this we continuously look for different revenues and that would diversify our borrowings and definitely even in the bonds market the response is positive and the expected cost has fallen but right now we find that there are other avenues where we are able to raise fund even at a more cheaper rate and the difference is significant and therefore just going a little slow in going ahead with the bonds borrowing but probably we will have some borrowings in this quarter and then in the coming year.

Adesh Mehta: So sir what could this other avenues be.

Kailash Baheti: Other avenues are mainly the CP market.

Adesh Mehta: So what is our incremental cost of funding from the CP market?

Kailash Baheti: It is between 7% and 7.5%.

Adesh Mehta: And another thing Sir how is the collection efficiency shaping up in the unsecured loan book.

Kailash Baheti: Unsecured loan book the collection efficiencies are remaining very steady at around 97%, 98% and in the worst of time, we had actually 98.5% so November, December were even better but even January it has been holding on very well.

Adesh Mehta: So it was 98.5% in November, December and it has come down to 97% in January would that be a fair assessment.

Kailash Baheti: 97.5% in January.

Adesh Mehta: It has come out by around 100 bps.

Kailash Baheti: So it has actually gone up during the demon period, I would put it that way.

Adesh Mehta: Thank you sir. That is it from my side I have other housekeeping questions, which I can take it offline. Thank you.

Moderator: Thank you. The next question is from the line of Ashwin Balasubramaniam from HSBC Asset Management. Please go ahead.

Ashwin B: I have a couple of questions first is if I look at your disbursements in the mortgage book it has come down quite a lot whereas the SME which also caters to pretty much the similar customer segment has come down by much more smaller amount if I look at it on a sequential basis. So just wanted to understand the reason why those two are different, such a broad difference is there on a sequential basis there and the second question is the tier I capital I think has come down from 15.9% to 15.1% sequentially although the AUM has remained flat. So what is the reason for the decline in tier I?

Kailash Baheti: So to your first question the mortgage and SME customers are different. In mortgage, we have 100% secured and SME is completely unsecured. How do we do assessment of SME customers, all our SME customers or 90% of our SME customers will have a bank line, the reason why they to us is that the banks are not nimble enough to provide the funds when there is immediate need and the NBFCs are able to step in that space and provide very quick finance. So the SME customers are on in the usual regular businesses, they have banking lines and therefore they were the least impacted when the demon happened in fact some of them have actually had better business because those who were doing outside books suffered and those were doing books did actually well and that is the reason SME has not suffered while immediately after the demon in the month of November, there was a decline it recovered very quickly and that is also the reason why collections have held up. On the other hand, mortgages which is both home loan as well as LAP is for both business purpose as well as for other purposes and since the value of underlying security was uncertain in the months of November and December that segment got far more impacted. To your second question on tier I, there has been some investment in one of our subsidiaries not investment and loan temporary loan which we have given to one of our subsidiaries and as per the RBI prescribed calculation; we have to lock it off from our tier I capital. This money will come back in the month of maybe this quarter or next quarter and then our tier I capital gain adequacy will get restored.

Ashwin B: Thank you.

Moderator: Thank you. We have the next question from the line of Nidhesh Jain from Investec. Please go ahead.

Nidhesh Jain: Thanks for the opportunity Sir. Sir first question is on margin so if I look at the margins they have improved quite a bit despite you are having some interest income reversal so it is reasonable to expect that margins will improve from here onwards as well when you see gross NPA normalizing over next two to three quarters.

Sanjay Chamria: Well I think the NPAs would improve there will be a positive impact on the margins because of a lesser interest reversals. At the other hand, there could also be a downward pressure on the margin with the benign interest rate scenario when we have to reduce also the rates to acquire more business to grow the loan book and to have a better quality book, but so therefore in terms of our outlook I think as I mentioned sometime back that we are happy to stay in the tune of 7.25% to 7.5% NIMs and there we have more or less stayed, so we do not intend to further push it up, would rather now focus on growing the loan book than improving the margins.

Nidhesh Jain: Secondly on the credit cost so how one should look at the credit cost in FY2018 especially when the PCR is low at the 25% so do you think the material correction in credit cost in FY2018 or it can take a bit of time.

Kaushik Banerjee: It is quite a complex scenario you see one our PCR we have improved by 4% in this tough year from 22% to 26% as on December and we have also shared that by March 2017 45% of our total book will be from the new origination having started under the branch making model from December 2015, in this the qualities about 40% superior, had it not been for the impact of the demon, we were expecting the NPAs to have peaked and start coming down from the third quarter. So due to this there is a setback of about one or two quarters and therefore certainly I would believe that next year or maybe from now on one or two quarters from now in terms of absolute amount we expect a reduction in the NPAs and only 30% of the book is yet to peak, 45% of the book is new and on the balance 55%, 25% has already peaked so I think we will have some impact maybe for couple of quarters and then we should expect reduction, this is what I can share.

Nidhesh Jain: And Sir what would be the PCR on the vehicle asset book ABF.

Kailash Baheti: Nidhesh, there is a complex scenario as far as NBFCs are concerned and we would not be so much focusing on the PCR because banks get tax break on provisioning and NBFCs do not get tax break on provisioning and for us it is always better or for the NBFCs it is always better to write-off a loan and take tax break instead of just keep on looking at the PCR and increase the provisioning. So our strategy until now has been that if something has moved into very hard bucket or we feel that it is unrealizable write-off rather than have higher level of provisioning so this is the dichotomy, you guys look at higher PCR, we look at more solid book and completely removing the dilute. So I would just leave it at that.

Nidhesh Jain: That is it from my side thank you.

Moderator: Thank you. The next question is from the line of Abhishek Jain from SKS Capital. Please go ahead.

Abhishek Jain: Two questions, first is basically how our tractor portfolio is shaping up right now at this point of time and what kind of growth you are seeing it for Q4 and again FY2018 and can you shed some light on this tractor portfolio please.

Sanjay Chamria: Kaushik you would like to take it.

Kaushik Banerjee: Given the impact of demonetization and the fact that tractors have been fairly severely impacted as a result of that even though it is kind of coming back to normalcy the view right now is to continue to focus on ensuring that the overall collection efficiency in the tractor portfolio improves and the intent is not to take a very aggressive stand on tractor disbursements and instead focus on generating quality business at an appropriate rate of growth while ensuring that the overall performance on the portfolio side continues to show an improvement. So tractors have traditionally and historically been relatively volatile and demonetization is not headed. So here the intent is to ensure that the… so what I was saying is that it is probably prudent to peg a moderate growth rate on tractors and ensuring with the overall portfolio quality of the tractor portfolio is superior.

Abhishek Jain: And second thing sir you have talked about NIMs at somewhere around 7% guided for this year going forward but our this quarter where the NIMs are 7.19% how you see going forward sir. So how exactly because now the cost is coming down, so do you think this is going to be much better?

Kailash Baheti: On this we have already mentioned that we would be looking at a range of 7.25% to 7.5% and as we said that line cost of funds will come down, there could also be case for slight reduction in our lending rates so that we are able to grow the book, we are very comfortable at a NIM of 7.25% to 7.5%.

Abhishek Jain: Thank you.

Moderator: Thank you. Due to time constraint we will be able to take one last question. The last question is from the line of Deepak Purswani from IFMR Capital. Please go ahead.

Deepak Purswani: Thank you. I would like to understand in your SME portfolio which sector or industry segments are most impacted and how are they recovering now.

Kailash Baheti: We have already said that in SME we do not see any stress at all in any of the segments however externally as we know that the segments like jewelry, the segments like construction were initially very severely impacted and we had conservatively gone slow on them but we have not seen any significant stress on any of lines in which we land.

Deepak Purswani: But Sir just to add one more point on this that during our interaction with some of the SME customers especially wholesalers we could understand that during this demonetization period, I mean they were impacted, their payment cycles had increased and they were being completely drying up of demand in the market and of course now, it is resuming but in this period whatever losses they have incurred due to the deferment has not it been reflected in the portfolio or and one view have been that till December somehow through the circulation of older currencies this SMEs were managing but now they will see the real impact after January, February.

Sanjay Chamria: So as Kailash shared that the impact of demonetization we see in two ways one is the existing portfolio quality and the other is the fresh demand. In the existing portfolio quality rather we saw that SME had best collection months in November and December and that as you said rightly could be due to the region that a lot of people introduce their money in the system and therefore they wanted to repay the high-cost loans but in the month of January now the January collections are also available with us we find that even January, the collections have been quite robust and slightly better than October while November and December were significantly better than October so therefore I would say that till now we have not seen any adverse impact of the slowdown or reduction in their turnover so far as the fresh demand is concerned of course it did go down during November because people were apprehensive about the impact and did not know as to how to deal with this, so therefore the fresh borrowing did go down and in the month of January now, it has returned to near normal but I would completely agree with you that it is very difficult to assess the impact of the demon and six months from now, we have GST coming in, so we are also evaluating certain models to do a predictive analysis of how the SME portfolio is going to behave and therefore what are the changes that be on a proactive basis need to do in our portfolio going forward so that we do not land in a situation where the NPAs could be much higher but then that is still a work in progress.

Deepak Purswani: If I may just ask one more point would you have the collection efficiency figures for SME portfolio as on January.

Sanjay Chamria: SME has the best collection efficiency percentage and it hovers between 98.5% to 99.1%.

Deepak Purswani: Thank you.

Moderator: Thank you very much. That was the last question ladies and gentlemen. Now I would like to hand the conference back to Mr. Kaitav Shah from SBICAP Securities for closing comments.

Kaitav Shah: On behalf of SBICAP Securities, I would like to thank all the participants for joining in this call and thanks to the management for giving us this opportunity. Thank you.

Moderator: Thank you very much. On behalf of SBICAP Securities Limited that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.